MINUTES

BOARD OF TRUSTEES
PUBLIC EMPLOYEES' RETIREMENT FUND
143 West Market Street, Suite 602
Indianapolis, IN 46204

March 2, 1998

TRUSTEES PRESENT

Richard Doermer, Chair
Nancy Turner, Vice Chair
Dwayne Isaacs
Dr. Teresa Ghilarducci
Steven Miller

OTHERS PRESENT

Richard Boggs, Burnley Associates
Kris Ford, Mercer Investment Consulting
Kellie Scheurell, Mercer Investment Consulting
Mary Beth Braitman, Ice Miller Donadio & Ryan
Victoria Yamasaki, Coopers & Lybrand
Donald Zakrowski, Coopers & Lybrand
Tom Richards, Coopers & Lybrand
Larry Francisco, Coopers & Lybrand
Doug Todd, McCready & Keene, Inc.
Joe Thomas, McCready & Keene, Inc.
Jim Sperlik, Legislative Services Agency
Lee Tanner, Prime Capital Management
Philip Barnes, Prime Capital Management
David Withrow, Prime Capital Management
Stephen Tufts, Prime Capital Management
Garth Dickey, PERF Director
Patrick Lane, PERF Executive Assistant to the Director
Bill Hutchinson, PERF Division Director, Pension Administration
Mark Webb, PERF General Counsel
Tom Parker, Director, 1977 Police Officers' & Firefighters' Pension & Disability Fund
Linda Petro, Recording Secretary

ITEMS MAILED TO THE BOARD PRIOR TO MEETING

A. Minutes of November 17 & 18, 1997 Meeting
B. Statements of Retired and Disabled Members - PERF, Judges' Retirement System, Conservation & Excise, and Police & Fire
C. Coopers & Lybrand Draft Discussion Report

A quorum being present, Chairman Doermer called the meeting to order.

1. EXECUTIVE SESSION

An Executive Session of the Board of Trustees was conducted to discuss personnel matters.

2. APPROVAL OF MINUTES

Following review by the Board,

MOTION duly made by Steve Miller, seconded by Nancy Turner and unanimously carried to approve the Minutes of the November 17 & 18, 1998 meeting.

3. REPORT ON OUTSIDE EVALUATION OF INVESTMENT ACCOUNTING CONTROLS & STAFFING ADEQUACY

Victoria Yamasaki, Donald Zakrowski, Tom Richard and Larry Francisco were in attendance representing Coopers & Lybrand.

A discussion draft of the report to the Board was distributed to the Trustees in advance of the meeting. Ms. Yamasaki began by discussing Phase 1 of their engagement, which was to access PERF's investment process and controls. She noted that Coopers had looked at policies and procedures in place and documented those. Numerous interviews were conducted which included all five Board members, the Director, the Controller, seven PERF employees, three investment managers, one custodian, both consultants, two State Board of Accounts employees, the Budget Director, and the Assistant to the Governor. Many types of reports and shelf materials were examined. That information was then thrown up against a "best practices" model. These "best practices" are really nothing more than best management techniques. This model is typically used to optimize the efficiency and effectiveness of an operation and is centered around a control environment looking at roles and responsibilities. It is the detailed, day-to-day execution of responsibilities in accordance with the investment guidelines. Lastly, they looked at overall monitoring, not only of the compliance elements of the guidelines, but also the Board of Trustees' involvement and report monitoring and timely follow-up.

Putting that into practical terms, Coopers' review included the following:

Control Environment - What they found was that PERF has a very strong Board that is attentive to investment policies and strategic initiatives. Next they looked at how this is all monitored. Although PERF has an effective Board that looks at the strategic initiatives and a Director who is the conduit from the Board, they also need a strong Investment Department that helps monitor the money managers, monitor the contractual limitations, and monitor the day-to-day activities that go on. Currently, that does not exist. Also, an internal audit function is needed to evaluate the effectiveness of the controls. There must be an ongoing monitoring function that will insure that the controls are going to carry the Fund through into the year 2000 and beyond through a continuous evaluation of that process. Concerning policies and procedures, PERF has nothing written down. Coopers has endeavored to write those policies/procedures that will help to implement the directives in the guidelines formulated in the Restatement of Investment Policy. With all of that, continuous and interactive communication is needed from the Investment Department up to the Director and to the Board. That has to continuously go on with all the external service providers. With that, PERF will be brought into the "best practices" model and thereby promote efficiency, mitigate the risk of asset loss, and help insure the reliability and accuracy of the financial and operational information.

Looking further at the control environment and all of the changes that PERF has undergone in the past few years with changes in leadership, changes in the Administration, changes in the systems, significant prolonged staffing inadequacies, etc., what you are left with is management having to take on more and more responsibility beyond what normally would be intended for their level of assigned responsibility. Because of that, there is almost a perspective, out of a matter of necessity, that everybody needs to jump in, roll up their sleeves, and get the job done. Because of that, there has been a little less training on the part of the existing staff. Coopers strongly feels it is clear that staffing is needed. Once more of the infrastructure is built up, the hiring of additional staff will create a stronger control environment and permit people to function as they were intended to function throughout the process. The one key element, however, is managing the change when all these new people are hired. Any time you start to create new capabilities within an organization (new roles, new people), you have to be able to manage that in a very positive manner through team building and communication plan and delivery.

Monitoring of Trading by Investment Managers and Compliance with the Investment Guidelines - Coopers is well aware of Prime Capital Management's importance to PERF, both from an investment performance standpoint and from a monitoring standpoint. That monitoring came about through necessity several years ago. However, that is not "best practice" in terms of the fact that Prime is monitoring themselves and monitoring other managers. In addition, the monitoring is occurring at the end of the month and not during the month. So in effect, you could have a security that is bought and sold within a month that would not meet PERF's investment guidelines and would not be detected. There is indemnification against the investment managers; however, that is only good as long as the equity of a manager is strong enough to cover any risk of loss. Additionally, since the monitoring is only occurring at the end of the month, it is very conceivable that a security could be 20-45 days old before it would be detected, which is a significant time period to hold an investment that is not meeting the Fund's guidelines and could cause a loss.

Mr. Dickey interjected that the guideline checking is currently being done and is done by Prime. That does, from time to time, show up guideline violations. When violations are found, both Dick Boggs and Mr. Dickey are notified. Most of those gaffes are generally interpretative differences. The main thing is not that PERF has a compliance problem, but rather a control problem because there is not in-house staff to do the job and do it as thoroughly as needed.

> We don't think there are abuses taking place. We think we have good managers we can trust. But just because you can trust them doesn't meant that you don't want to monitor them, and all we're calling for here is a recommendation that we staff up to adequately monitor them.

Mr. Zakrowski continued that with the move to equity and global investments the Fund will be entering a more complicated arena that needs to be considered in the future. Thus, Coopers is recommending that the monitoring function be brought in-house or outsourced to somebody who is truly independent of the investment manager function. If that function is brought in-house, an investment in technology will be required by PERF.

<u>Reconciliation Procedures</u> - Investment transactions are currently completed on a weekly and a monthly basis by PERF accounting staff by reconciling the printed weekly and monthly statements from the investment custodian and comparing these statements to both the broker's advice received directly from the broker and the trade ticket received directly from the investment manager. This is a manual verification that takes place on a weekly and a monthly basis when the custodian reports are received. The investment managers are required by their respective investment contracts and the investment guidelines to monthly reconcile the investment portfolios managed by them with the investments held by the investment custodian. Coopers feels that's redundant and that a review of the investment manager reconciliations as called for in the investment guidelines, as well as some testing of some of the transactions, would meet the reconciliation requirements. Additionally, the reconciliation currently completed by PERF staff takes approximately one month to complete. So the October, for example, financial statements are not completed until the end of November, which is really not timely enough for management to take appropriate action when needed.

<u>Contract Compliance</u> - Each investment manager, custodian and consultant is required to enter into a contract with PERF on a regular basis. Compliance with the investment contracts is not currently being monitored by PERF staff on a regular basis. In one instance, a manager is not completing the reconciliations required by the investment contract. This would be detected if monitored on a regular basis. In addition, there are certain business issues that should be monitored (year 2000 issues, disaster recovery planning, significant changes in operation, etc.).

Custodian Effectiveness - Existing controls are currently effective to handle the day-to-day transactions. However, PERF has not reached the point where they are fully utilizing all of the custodian services. Thus, Coopers recommends full utilization of the existing services, and then from there business realities dictate that an evaluation of other custodians would be warranted.

Internal Audit Function - The Board of Trustees has a fiduciary responsibility to monitor all activities of the Fund including administrative, investment operations, and benefit processing. An internal audit function would assist in completing those tasks. This added control element would periodically review all aspects of PERF's operations and make recommendations to strengthen controls on a regular basis. This added function would enhance the fiduciary control administered by the Board of Trustees and add a higher level of comfort that compliance procedures are in place and functioning appropriately.

Staffing Inadequacies - Currently, PERF has outsourced the following four investment functions: investment management of the portfolio, monitoring of investment managers for compliance with investment guidelines in the contracts, investment custody, and investment consulting and review of the performance of investment managers. Some of the additional functions that should occur relative to the investment function of PERF if staffing levels were increased are "what-if" scenarios and stress testing of investment performance. Also, a PERF Investment Department staff would occasionally recalculate the investment performance statistics developed by the custodian and consultant to verify procedures are AIMR compliant and are calculated based upon daily cash inflows and outflows. Many performance statistics could be developed, tracked and monitored for custodial activity, broker transactions, and securities lending as well. Thus, it is Coopers' recommendation that 3-5 individuals be hired to make up an Investment Department that would monitor some of these aspects. They also recommend that the Board and the Director consider the hiring of a Chief Financial Officer ("CFO") to oversee the financial operations of PERF. The CFO would be a liaison for both the proposed internal audit function and the external audit function conducted by the State Board of Accounts. This position would also assist in the attraction, training and retention of qualified individuals within the accounting function and would implement a policies and procedures manual as also recommended by Coopers.

Mr. Richards continued with discussion of Coopers' benchmarking results. In all, 75% of the targeted audience responded. Some of the results were as follows:

- The average investment portfolio for all respondents was $10.7 billion as compared to $8.1 billion for PERF. The overall selection of the participants was weighted more heavily toward larger funds primarily due to the anticipated future growth of PERF.

- PERF currently provides retirement services for approximately 950 public entities within the State of Indiana. Looking at comparative staffing levels, PERF would need an additional 60-90 employees to reach the median. (Of the total respondents to the study, five of the 25 serviced 15 or fewer public entities.)

- 70% of the respondents had some form of internal monitoring of their performance results. PERF primarily does not.

- 93% of the respondents monitor compliance internally either partially or with an external service. PERF is monitored entirely by external advisors.

- PERF participates in a securities lending program. Participation is, however, limited to 40% of the investment portfolio. Of those respondents participating in a securities lending program, 15 of 23 place no restrictions on the percentage of the investment portfolio allowed to participate in the program.

- PERF does not currently have an internal audit function. Respondents indicating the existence of an internal audit function report an average staff size of 2.5 employees.

Mr. Francisco continued with discussion of Phase 2 of Coopers' engagement — the benefits processing review. He noted that during the course of their interviews, they had noted the following areas which need attention:

- Numerous members have no addresses or incorrect addresses resulting in difficulties in mailing annual statements or resulting in statements being returned.

- Beneficiaries with dormant (inactive) accounts and no forwarding addresses result in outstanding checks on the bank reconciliation which are unable to be resolved. A similar situation exists with regard to returned checks.

- It is common for members to report errors reflected on their statements since the present Director began disclosing serviceable credits on the statements. PERF omitted disclosing serviceable credits from the statements under previous directorships because of the numerous errors that were known at the time.

- Until recent actions were taken by management, security maintenance performed on beneficiary accounts was not routinely monitored or reviewed. Security issues, from a historical perspective, could result in inaccuracies or improprieties and, therefore, should be evaluated.

- PERF's database is cross-referenced to locate deceased beneficiaries only two times per year which could result in improper payments between verification dates; however, the magnitude of the cost of running additional cross-reference checks on deceased beneficiaries should be investigated to determine whether such amounts outweigh the potential improper payments.

Coopers was also made aware of various customer service issues through discussions with PERF staff which warrant further evaluation. These included:

- Available retirement counseling cannot be scheduled until one year prior to retirement and there is a 4-5 month waiting period to schedule this meeting.

- Statements are mailed only on an annual basis versus a semiannual or quarterly basis.

- Current data made available to PERF staff indicated that 50% of retirement benefits will be handled within 60 days of receipt, and it will take over 100 days for 90% of the benefits to be processed.

- The level of customer calls versus the number of customer service representatives results in some calls going unanswered.

Coopers would recommend the following:

- A full scale process control review which analyzes the current processing of the benefits and administrative functions and development of findings and recommendations to improve controls. (This is currently in the process of being implemented by engaging Coopers to perform the review.)

- Hiring additional staff (benefit counselors, processors, etc.) to assist in the completion of the work on a timely basis. More importantly, monitoring controls should be enhanced.

- The development of a Benefits Committee consisting of two Board of Trustee members and the Director. This committee would meet regularly to discuss benefit issues and monitor statistics developed to appropriately analyze service quality to beneficiaries and accuracy of beneficiary reporting.

- Develop an internal audit function which will include benefit and administrative processing testing and analysis on a regular basis.

This phase of Coopers' engagement will be discussed further at the next scheduled meeting of the Board of Trustees.

4. PERFORMANCE ANALYSIS

Richard Boggs was present representing Burnley Associates.

Mr. Boggs briefly summarized that all 15 money managers were more or less within commercial tolerance during the last quarter of 1997. As of January 1st, all the 50-50 Index managers had substantially completed the transition toward being LBA managers. Thus, moving forward, all managers will be LBA managers and judged as such.

Prime Capital had a good 4th quarter. Their rates had been disappointing the first three quarters of the year. During the 4th quarter they made up about half of what they were lagging for the first nine months, so they finished 30 basis points below the LBA.

As concerned cash flows and sources of flows for the new equity managers, Mr. Boggs noted that there was a negative net contribution in the 4th quarter due largely to the 13th check mandated by the legislature last year. Mr. Dickey added that this is not the beginning of a negative trend that needs to be planned for. "This is a one-time aberration at this point. Things are pretty much at a stable point where there will be generally positive small cash flows. This is nothing to be concerned about. It will be watched and looked at more closely in cooperation with the actuaries on an ongoing basis."

Mr. Boggs continued that historically the cash flow allocation has been addressed in each of the Board's meetings. For some time, everything had been going in and out of the LBA -5 account. The point was then reached where both the LBA -5 and the 50-50

Index Funds were becoming small enough that they needed to be combined. It was recommended that those two accounts be managed as a one or two year-type duration fund, a little longer than a typical money market fund, but one with short maturity for liquidity reasons. That fund (the Reallocation Fund), in addition, would probably be used to fund managers. Thus, it was Mr. Boggs' recommendation that the 2nd quarter cash flows, in and out, be handled through the Reallocation Fund.

MOTION duly made by Steve Miller, seconded by Teresa Ghilarducci and unanimously carried that the 2nd quarter 1998 cash flows of contributions from employers and distributions to beneficiaries be handled through the Reallocation Fund.

Mr. Boggs continued that the Reallocation Fund will be running dry in another month or so. The $100 million per month which has been placed in the stock market has been pulled from that fund. Thus, it was suggested that there be a move toward correcting some of the over concentrations in the three largest active manager portfolios (Prime, Bank One, and NBD). Taking the long term view, the rule of thumb seems to be to move forward with five bond managers, each managing $300 million, and the rest indexed. That would take PERF to half of the 40% bond position. Thus, it would make a certain amount of sense that the cash flow needed to continue to put $100 million per month into the equity market could be achieved simply by taking those "excessive" funds away from these three managers. In so doing, there would be a way to generate the cash flow needed and bring these managers more or less in line with where they will be if retained. Following some further discussion:

MOTION duly made by Nancy Turner, seconded by Teresa Ghilarducci and unanimously carried to delegate authority to the Investment Committee to determine the amount and manner by which additional funds will be drawn from the actively managed portfolios of Prime, NBD, and Bank One as the next source of funding for the transition to equities. The Investment Committee will then report back to the full Board of Trustees.

Mr. Dickey noted that the Investment Committee had originally been constituted to conduct PERF's first series of money manager searches. It has also been suggested that a Benefits Committee be created. He offered to the Board that they might want to consider whether to go ahead and create a Benefits Committee and reconstitute the Investment Committee that for the last six months has been working on the manager searches. Kris Ford suggested that when establishing committees, the Board needs to establish committees with specific goals and not project oriented. Also, the Chairman, with the Director, should contact the Trustees and determine who might be on the committees. That would be done offsite in a private kind of way. Those committees would then be constituted for a specified period of time. Thus, everyone would know who is on what committee and for what period of time and exactly what that committee's authority is, etc.

MOTION duly made by Nancy Turner, seconded by Dwayne Isaacs and unanimously carried to authorize creation of a Benefits Committee and reconstitution of the Investment Committee. All discretion will be given to the Chairman to invite the membership of those two committees and to set the terms of the appointments. The committees will be charged with making a report to the Board of any actions taken.

Prime Capital Management

Leland Tanner, Philip Barnes, David Withrow, and Stephen Tufts were in attendance representing Prime Capital Management.

Mr. Tanner began with a portfolio performance summary for the quarter ended December 31, 1997. During that quarter the PERF account exceeded the LBA Index by 26 basis points and was in the 18th percentile of all managers reported by Burnley Associates. Prime's longer term performance continues to be good. For the past seven years their rate of return was 9.21% which exceeded the LBA Index by 56 basis points and was in the 35th percentile of all managers. For the past ten years their rate of return was 9.48% which exceeded the LBA Index by 30 basis points, and they were in the 30th percentile of all managers. In spite of their under performance in 1996 and 1997, their long-term performance is still in the upper third of all managers in the universe and exceeds the base benchmark LBA performance. Prime's out performance of the index continued during January 1998 with a rate of return of 1.50%, exceeding the index by 22 basis points.

In the last few months interest rates have come down and broke the 6% level. These are not, however, record low rates. If you look at the time period of 1950 to 1957, long treasuries averaged 2.89% and the CPI averaged year-over-year 2.41%. From 1958 to 1966 there was stable low inflation with a 30 year treasury during this period averaging 4.19%, and the CPI average during that period was 1.60% per year. Then 1967 began the era of oil embargo and the Viet Nam War which resulted in increasing inflation. At that time the 30 year government yield peaked at 14.05% and inflation peaked at 13.30%. During 1982 to 1991 inflation moderated with the long treasury bond yield, dropping from over 10% to 7.40%. The average inflation during that period was 3.92%. Then from 1992 to 1997 there was stable low inflation with the long treasury yield declining to 5.93% at the end of December and year-over-year inflation was 1.70%. This period compared with the 1958 through 1966 stable low inflation period. The average real yield (nominal yield minus CPI rate of inflation) averaged 2.45% for the 48 year period. It was 4.23% on December 31, 1997, or 178 basis points above the 48 year average. This is truly a high real rate of return on bonds over this period. The last period of stable low inflation occurred in the years 1958 through 1966 during which time the year-over-year inflation was 1.60% and the 30 year real yield was 2.59%. If you assume that the 1998 rate of inflation remains unchanged at 1.70% and the real yield falls from 4.23% at the end of 1997 to 3.41% (the average of the current yield and the 40 year period), that would forecast a yield on the 30 year treasury of 5.11%. If the market continues to experience low rates of inflation, this is the kind of yield curve and yields that could be expected sometime in the near future.

5. UNITIZED ACCOUNTING UPDATE

Mr. Dickey noted that great strides have been made with National City Bank. The test run for the period of July 1 to July 30 should be completed this week. That will be exhaustively explored to make sure it all worked. If it does, the Prime PERF-related and Prime non PERF-related will all collapse by the introduction of unit trust accounting, and that will be done retroactive to the beginning of the fiscal year.

6. VALUATION REPORTS

Doug Todd and Joe Thomas were in attendance representing McCready & Keene, Inc.

Mr. Todd began by discussing the PERF Executive Summary report for July 1, 1997. Contributions for the State were $81,545,985; for the municipalities $101,345,352; and a total contribution of $182,891,337. The total annual cost as a percentage of anticipated payroll was 6.6% for the State and 5.9% for municipalities for a total of 6.2%. Experience gain for the State was $79,011 and for the municipalities $52,661,259. Looking at employee data, the Fund has remained very stable with the number of people coming in and going out pretty much balancing each other. The average annual benefits were $176,509,450 with another $10,363,939 for disabled participants.

Looking at the estimated gains or losses by source, for the State there was a loss of $20,800,000 and a gain of $34,500,000 for the municipalities. A good part of that was due to the fact that there was a salary increase implemented for State employees effective January 1, 1996 and January 1, 1997. Both the State and municipalities registered a gain in the return on assets with $17,600,000 and $20,700,000 respectively. A cost-of-living adjustment provided last year actually resulted in a slight gain of about $100,000 each for both the State and municipalities. Finally, miscellaneous items (mortality, disability, etc.) registered a gain of $3,179,011 for the State and $2,638,741 for municipalities.

With respect to the Excise Police & Conservation Officers' valuation, McCready made some fairly major assumption changes but major only in that they were trying to get the plan in line with PERF and the other plans. Mr. Dickey noted that one of the things the actuaries have been doing gradually over the last two years is trying to bring all of the plans, as appropriate, up to the same level of standard assumptions. Excise Police was one where there was one major correction to be made because an old mortality table was being used. Mr. Todd continued that those assumption changes were made as follows: the interest rate was lowered from 7.50% to 7.25%, the salary scale was lowered from 6.50% to 5.00% annually, and the mortality table was changed. Those changes resulted in the total annual cost of the plan escalating from $1,382,900 in 1996 to $1,675,671. The total cost as a percentage of anticipated payroll rose from 15.9% to 17.6%. The plan is now on track, assumption wise, with all the other plans. The unfunded liability of the plan last year was $8,008,028. With the actuarial losses due to salary scale, that jumped up to $9,423,308 and then to $12,136,006 with the revised assumptions.

With respect to the Judges' Retirement System, the fund is not actuarially funded but is a pay-as-you-go plan. The unfunded liability in 1996 was $90,729,621 and in 1997 it was $80,648,195 with a change in assumptions. That change involved increasing the interest rate from 7.00% to 7.25%, once again trying to make all the plans uniform. The normal cost of the plan decreased from $5,328,060 in 1966 to $4,581,177. Mr. Dickey noted that while there is a recommended funding level, in recent years the ability has existed to add additional funds in the budget a little beyond that. Thus, there has been a gradual buildup. While the fund is not currently on an actuarially sound funding basis, the unfunded liability is being decreased in part through higher contributions.

The Legislators' Defined Benefit Plan has a structure which was frozen at a point in time, and, thus, is not a growing universe. Today, any new legislator participates in the Legislators' Defined Contribution Plan. Looking at the Defined Benefit Plan for 1996, contributions were $182,405. With the same assumption changes as those made for the Judges' System, contributions were $170,169 for 1997.

Changes were also made in the Prosecuting Attorneys' Retirement Fund increasing the interest rate slightly from 7.00% to 7.25%. Contributions to the plan in 1996 were $308,597. With the interest rate change, that decreased to $275,266. The cost as a percentage of anticipated payroll was 2.8% in 1996 and decreased to 2.3% in 1997. Prosecutors have a nice plan, but there is an offset of the PERF benefit. This is the one plan with such an offset and is also the one plan that is structured in such a way that you expect there to be joint service. In 1996 there were 182 eligible active participants and 192 in 1997.

7. LEGISLATIVE UPDATE

Mary Beth Braitman, Ice Miller Donadio & Ryan and Mark Webb, PERF General Counsel, summarized legislation passed during the last session of the General Assembly which will impact PERF.

Senate Bill 120 - (1) Allows a PERF/TRF member to purchase all or part of their out-of-state service (current law provides for all or none), (2) Allows a person to transfer all or part of their PERF/TRF service to another governmental plan (current law provides for all or none), (3) Clarifies that a rehired PERF/TRF member may only claim credit for prior employment periods if they have not transferred those same years to another governmental plan, (4) Allows a surviving spouse or surviving dependent entitled to a member's PERF/TRF annuity savings account balance to elect to receive a lump sum payment of that balance or a cash out of the member's federal income tax basis as of 12/31/86 (a tax free amount) with the balance being annuitized, (5) Clarifies that death benefits must be claimed within 3 years of a member's death unless the PERF/TRF Board waives the time, (6) Allows a PERF/TRF member to receive PERF/TRF disability if they become disabled under Social Security award while receiving a salary or employer provided income protection benefits or while on FMLA leave, (7) Adds the ability for the PERF Board to contract for up to 5 years, (8) Eliminates the current 4 year limitation for PERF members to purchase service credits, (9) Makes conforming change to the 1977 Police & Fire Fund to reflect that park rangers must complete the required number of weeks of training at the Indiana Law Enforcement Academy, (10) Provides that benefits (retirement, death and disability) for members who converted from the 1925, 1937 or 1953 police/fire fund ("Old Funds") and who terminate employment prior to June 30, 1998 are paid from the 1977 Fund rather than from cities and towns through the 1925, 1937, and 1953 Old Funds (as under current law), (11) Reduces the normal retirement age in the 1977 Police & Fire Fund from 55 to 52, (12) Clarifies the appeal process for class of impairment determinations in the 1977 Fund, (13) Moves park rangers from PERF to the 1977 Fund, and (14) Allows the PERF Board to consider claims for prospective only disability benefits under new disability provisions in Section 5, from April 1, 1994 and thereafter.

Senate Bill 190 - Provides that when a town establishes a board of metropolitan police commissioners, or when a town becomes a city, a police officer employed by the municipality is a member of the 1977 Fund unless the police officer elects to continue as a member of PERF.

House Bill 1072 - Provides a cost-of-living adjustment (COLA) to members of PERF and TRF.

House Bill 1162 - Increases the death benefit from $6,000 to $9,000 for members of the 1925 Police Pension Fund, the 1937 Firefighters' Pension Fund, the 1953 Police Pension Fund, and the 1977 Police Officers' & Firefighters' Pension & Disability Fund who die after December 31, 1998. Increases the line of duty death benefit from $75,000 to $150,000 for members of the 1925 Police Pension Fund, the 1937 Firefighters' Pension Fund, the 1953 Police Pension Fund, and the 1977 Police Officers' and Firefighters' Pension and Disability Fund who die after December 31, 1997.

House Bill 1213 - Increases the salaries of the Governor and the Lieutenant Governor, beginning when the individuals elected in 2000 assume those offices. Increases the salaries of the Secretary of State, the Auditor of State, the Treasurer of State, and the Clerk of the Supreme Court, beginning when the individuals elected in 1998 assume those offices. Increases the salaries of the Superintendent of Public Instruction and the Attorney General, effective January 1, 1999. Provides a $12,000 annual housing maintenance allowance for all state elected officials except the Governor effective January 1, 1999. Provides a housing maintenance allowance of $6,000 for all elected state officials except the Governor for the period July 1, 1998 through December 31, 1998.

House Bill 1245 - Provides that the State and a political subdivision may agree to defer a part of an employee's compensation and may procure investments appropriate for a nonqualified deferred compensation plan. Establishes the Deferred Compensation Committee. Provides that the Deferred Compensation Committee may approve proposed funding offerings for the State Employees' Deferred Compensation Plan. Requires all amounts deferred under deferred compensation plans for State or local employees to be put into a trust for the exclusive benefit of plan participants. Provides that the Deferred Compensation Plan may include provisions to allow participants to make elections, give directions, and receive services through technological methods.

House Bill 1253 - Allows a local port authority that is operating a railroad to establish a retirement plan for the benefit of the Port Authority's railroad employees and past railroad employees who are not members of PERF. Provides that the retirement plan may not require contributions from an employee that exceed 6% of the employee's wages or salary.

Mr. Webb noted that there were a host of other bills that never received hearing. Some of those included a judges' bill which would have brought the Rule of 85 to the Judges' Retirement System, a bill to increase the multiplier in PERF from 1.1% to 1.5%, and a bill which would have made the Treasurer of State the Chairman of the Board of PERF and TRF.

8. ADDENDUM TO RESTATEMENT OF INVESTMENT POLICY

The Board adopted a Restatement of Investment Policy on September 12, 1997 covering all the Fund's other assets (except for the Pension Relief Fund, the Legislators' Defined Contribution Plan and the Annuity Savings Accounts). The addendum under consideration today (Exhibit A) concerned the Annuity Savings Accounts --- what options are available and how that money is to be managed. Following review and discussion:

MOTION duly made by Steve Miller, seconded by Nancy Turner and unanimously carried to adopt the Addendum to the Restatement of Investment Policy.

MOTION duly made by Dwayne Isaacs, seconded by Steve Miller and unanimously carried to include the Legislators' Defined Contribution Plan in the unit trust accounting and manage the portfolio in the same manner as the overall PERF portfolio is managed with a long-term target of 60% equities and 40% bonds. Such action will be incorporated into the Restatement of Investment Policy with inclusion of the Legislators' Defined Contribution Plan as part of the unit trust accounting.

9. PROPOSED RULE CHANGES

A packet of proposed rule changes (Exhibit B) was distributed to the Board. These changes were previously discussed with the Board and have gone through the necessary steps — publication, public comment, etc. Board action is simply needed to adopt the rules without any changes.

MOTION duly made by Nancy Turner, seconded by Teresa Ghilarducci and unanimously carried to adopt the proposed rule changes as noted in attached Exhibit B.

10. ADMINISTRATIVE MATTERS

Quarterly Financial Report

Copies of the quarterly financial report were distributed to the Trustees (Exhibit C). Mr. Dickey reported that temporary staff was $99,957.36 over budget due, in part, to the fact that PERF's new MIS Director and Network Administrator are not full-time employees but working on a temporary basis.

11. RECESS

With no further business, the Board recessed to reconvene at 8:30 on March 3.

MINUTES

BOARD OF TRUSTEES
PUBLIC EMPLOYEES' RETIREMENT FUND
143 West Market Street, Suite 602
Indianapolis, IN 46204

March 3, 1998

TRUSTEES PRESENT

Richard Doermer, Chair
Nancy Turner, Vice Chair
Dwayne Isaacs
Dr. Teresa Ghilarducci
Steven Miller

OTHERS PRESENT

Richard Boggs, Burnley Associates
Kris Ford, Mercer Investment Consulting
Kellie Scheurell, Mercer Investment Consulting
Tom Christofferson, Barclays Global Investors
Karen Norwood, Barclays Global Investors
Andy Olma, Barclays Global Investors
Nancy Feldkircher, Barclays Global Investors
James Barrett, Northern Trust Quantitative Advisors
Kristen Hart, Northern Trust Quantitative Advisors
Barry Hastings, Northern Trust Quantitative Advisors
Robert Deere, Dimensional Fund Advisors
Rex Sinquefield, Dimensional Fund Advisors
Carol Wardlaw, Dimensional Fund Advisors
Christopher Corappi, J. P. Morgan Investment Management
Rick Nelson, J. P. Morgan Investment Management
Frank Pfeffer, J. P. Morgan Investment Management
Stephen Rich, J. P. Morgan Investment Management
Gary Fencik, Brinson Partners
Robert Moore, Brinson Partners
Robert Jones, Goldman Sachs Asset Management
Lincoln Kinnicutt, Goldman Sachs Asset Management
Garth Dickey, PERF Director
Patrick Lane, PERF Executive Assistant to the Director
Bill Hutchinson, PERF Division Director, Pension Administration
Mark Webb, PERF General Counsel
Tom Parker, Director, 1977 Police Officers' & Firefighters' Pension & Disability Fund
Linda Petro, Recording Secretary

1. ADMINISTRATIVE MATTERS

New Units/Corrections

MOTION duly made by Steve Miller, seconded by Dwayne Isaacs and unanimously carried to approve the following new units:

PERF

1681 - Fairfield Township

Police & Fire

Franklin Township Fire Emergency Services

MOTION duly made by Dwayne Isaacs, seconded by Steve Miller and unanimously carried to approve the following corrections to new units voted upon at the November 1997 Board meeting:

PERF

1669 -Town of Whiteland

(At the time the Resolution Electing to Join the Public Employees' Retirement Fund was passed by the Town Council, the position of Sewer Laborer had not yet been filled. It was the intent of the Council to cover this position which was omitted from the original Resolution. The Council wishes to amend their Resolution to include this position for coverage effective January 1, 1998.)

1678 -Town of Carbon

(A request was received from the Town Council after the November 1997 Board meeting to remove the prior service credit date of January 1, 1998 from their Resolution Electing to Join the Public Employees' Retirement Fund. The town wishes to pick up all past service. The past service liability has been paid ($9,950.00).

2. PROSPECTIVE MONEY MANAGER INTERVIEWS

Kris Ford, Mercer Investment Consulting, summarized for the Board that in advance of today's meeting each of the prospective money managers had been given a discussion outline which they were asked to follow. Notably absent from that outline was a discussion of performance. The managers were asked to focus on their strategy and spend time talking about how they invest money. Each manager was allotted 20 minutes to make their presentation followed by a 10 minute question and answer period.
Mr. Boggs reiterated that the presenters would not be talking about performance. The Investment Committee had already reviewed performance. He also noted that the managers comprising each group are not exactly equals, but they are sufficiently close that that should not be a driving consideration. Also, the Board started out with four searches — large cap passive, large cap enhanced, small cap passive, and small cap enhanced. At

the small cap end, it turned out that it was difficult to distinguish between the passive small caps, so the two were collapsed into a single search, two of whom are enhanced and the other one who says they are active is really sufficiently enhanced that they are competitive as an enhanced indexer. So at the small cap level, the Board will see all three managers together.

With that introduction, the Board began the interview process as follows:

<u>Large Cap Passive Index</u>

Summary: These were index people and should replicate the S&P 500 Index. The placement would be approximately $700-$800 million (roughly 50% of the total equity portfolio).

The following firms were represented:

Barclays Global Investors
Northern Trust Quantitative Advisors, Inc.

<u>Small Cap Index/Enhanced Index</u>

Summary: The small cap index and small cap enhanced index were collapsed into a single search for reasons of market efficiency. While three different managers were considered, the major difference between them was that there were two enhanced strategies and one passive strategy. The concern was to look for the characteristics of the asset class plus return.

The following firms were represented:

Dimensional Fund Advisors, Inc.
J. P. Morgan Investment Management
Northern Trust Quantitative Advisors, Inc.

<u>Large Cap Enhanced Index</u>

Summary: In this category the concern was to make certain that risk controls are in place so that the portfolio retains the characteristics but provides enhanced returns. Most, if not all, of that would come through stock selection. The placement would be approximately $700-$800 million (approximately 50% of the total equity portfolio).

The following firms were represented:

Barclays Global Investors
Brinson Partners
Goldman Sachs Asset Management
J. P. Morgan Investment Management

Discussion of Interviews & Selection

Following presentations by each of the nine money managers in their respective categories, the Board opened the floor for discussion of the interviews. Based upon that discussion, the following actions were taken:

MOTION duly made by Teresa Ghilarducci, seconded by Nancy Turner and unanimously carried that the Department of Administration be notified of the Board's recommended selections, subject to the Director negotiating contract terms and fees and insuring that each of the selected finalists are in compliance with the Minority Business Enterprise provisions. Those selections and the initial allocations awarded were as follows:

Large Cap Index

Barclays Global Investors	-	$700 million

Small Cap Index/Enhanced Index

Dimensional Fund Advisors	-	2/3 of a total $700 million
J. P. Morgan Investment Management	-	1/3 of a total $700 million

Large Cap Enhanced Index

Brinson Partners	-	1/2 of a total $700 million
J. P. Morgan Investment Management	-	1/2 of a total $700 million

Once the Department of Administration has had an opportunity to review the Board's decision and insure that all vendors meet the required criterion, they will notify each manager of their selection.

3. NEXT MANAGER SEARCH

MOTION duly made by Dwayne Isaacs, seconded by Steve Miller and unanimously carried to direct the Investment Committee to work out the details, with the assistant of the Director and consultants, and lauch the next money manager search for Mid-Cap Domestic Equity, Growth and Value.

4. EDUCATIONAL SEMINAR

Mr. Dickey noted that the Board had previously discussed the possibility of having an educational retreat, either in Chicago or South Bend. By common consent, a date of May 18 was established for a one-day seminar to be conducted in Chicago at the Mercer Investment Consulting offices.

5. NEXT MEETING DATE

By common consent, the next meeting of the Board was set for June 1 and 2, 1998.

6. ADJOURNMENT

There being no further business, a Motion to adjourn was entertained, and by unanimous vote, the meeting was adjourned.